



STATE OF CALIFORNIA
FRANCHISE TAX BOARD
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KATHLEEN CONNELL
Chair

CLAUDE PARRISH
Member

B. TIMOTHY GAGE
Member

October 31, 2001

Chief Counsel Ruling
2001-1278

Re: *****

Dear *****:

You have requested a Chief Counsel Ruling on the application of a federal closing agreement executed on behalf of the Commissioner of Internal Revenue on ***** , in which the taxpayer agreed to pay a compliance fee to the Internal Revenue Service (IRS) with respect to certain errors on Forms 1099-B issued for tax years ending ***** .

According to the facts presented in the closing agreement and at our meeting on ***** , the taxpayer made certain errors on Form 1099-B information returns furnished to Fund shareholders (payees). ***** , the taxpayer improperly aggregated and reported to a Fund shareholder on a single Form 1099-B for the particular year all Fund redemptions occurring during that year. This error, in certain limited instances, may have caused the shareholder to mischaracterize the nature of the income. ***** , the taxpayer understated reportable gross proceeds on certain partial Fund redemptions on Forms 1099-B. The taxpayer voluntarily reported these errors to the IRS and represents that these erroneous reporting procedures have been corrected.

From the information you have provided, the federal compliance fee was computed based on the sum of two components: A *** per account penalty computed using actual figures for the ***** , and a second set of figures for ***** , roughly estimating partial redemptions and computing what amounts to an estimated fee. The total amount of the federal compliance fee, including both components, was ***** .

You propose that the California penalty amount resulting from the ***** , adjusted for the percentage of fund shareholders with addresses outside of

California, would be *****. You also propose that this amount be assessed on a Notice of Proposed Assessment based on the federal closing agreement.

Applicable Law

Revenue and Taxation Code (RTC) section 18622 requires a report of federal changes, including penalties. RTC section 19060(b) allows a Notice of Proposed Deficiency Assessment to be issued within four years from the date the taxpayer reports a federal change to FTB, where such notification is more than six months after the final federal determination.

RTC section 19183(a) incorporates Internal Revenue Code (IRC) section 6721 (failure to file correct information returns). RTC section 19183(b) incorporates IRC section 6722 (failure to furnish correct payee statements). RTC section 19183(f) provides that the penalty may be imposed and paid on notice and demand by FTB.

RTC sections 18631 et seq. require the filing of California information returns. RTC section 18631 incorporates various IRC sections, and requires that a copy of the federal information return may be required to be filed with FTB as well.

18 Cal. Code Regs. sections 18631-18681(a)(1) require information returns only with respect to payees whose last known address is within California.

18 Cal. Code Regs. section 19059(e)(1) specifies a closing agreement as a final federal determination.

RTC section 19101(c)(2)(A) provides that interest on any assessable penalty is imposed only if the assessable penalty is not paid within 15 days of notice and demand, and then from the date of notice and demand.

Discussion

The Franchise Tax Board (FTB) will generally follow the provisions of a federal settlement or closing agreement to the extent applicable to California law. *Montgomery Ward v. FTB* (1970) 6 Cal.App.3d 149; *Appeal of Von Housen Motors*, Cal. St. Bd. of Equal., March 3, 1982. Specifically, the provisions of a federal Form 906 closing agreement are considered to be the final federal determination of any matter included therein. *Appeal of Jack and Arla Meyer*, 96-SBE-012, May 15, 1996. Here, California law conforms to the penalty provisions

of IRC 6721 and 6722, but does not conform to the general federal compliance or user fee authority¹.

Holding

Based on the information you have provided, we agree that the sum of ***** represents an appropriate self-assessment of the California penalty against the taxpayer for tax years ending *****
*****, resulting from the provisions of the Form 906 closing agreement. For California purposes, this is treated as a penalty under RTC section 19183. As the penalty amounts are the same under both subdivisions (a) and (b) of RTC section 19183, and no apportionment is made in the federal closing agreement, it is not necessary to distinguish or apportion the penalty between the failure to file correct information returns to FTB under subdivision (a) and the failure to furnish correct payee statements to customers under subdivision (b).

This amount will be assessed on a Notice of Proposed Deficiency Assessment pursuant to RTC section 19060, and so no interest will accrue on the penalty if it is paid within 15 days from the date of the notice under RTC section 19101(c)(2).

The taxpayer's payment of the ***** penalty will satisfy the taxpayer's liability for tax years ending *****
*****, under RTC section 19183, if any, and any predecessor statutes, arising from the reporting errors described above. The taxpayer shall not be required to file information returns (Forms 1099-B) with the FTB and shall not be required to issue payee statements (Form 1099-B) to the payee to correct errors on the Forms 1099-B noted above.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayers and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes should they occur. This letter is a legal ruling by the Franchise Tax Board Chief Counsel within the meaning of Revenue and Taxation Code section 21012(a)(1).

¹ See Rev. Proc. 2001-8, 2001-1 I.R.B. 239, for a detailed list of legislative acts authorizing federal user fees.

Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or any notices or inquiries which might be issued.

Very truly yours,

Bruce R. Langston
Tax Counsel